

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-124415-08

Date:

July 23, 2008

Legend:

X =

A =

Trust =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This responds to a letter dated May 12, 2008, and subsequent correspondence, written on behalf of X, requesting relief for inadvertent termination of a subchapter S election under § 1362(f) of the Internal Revenue Code ("Code").

Facts:

The information submitted states that X was incorporated on Date 1 and made an S corporation election effective Date 2. Trust, a trust that was treated (under subpart E of

part 1 of subchapter J of chapter 1) as owned by A, was a shareholder of X. Thus, Trust was a permitted S corporation shareholder pursuant to § 1361(c)(2)(A)(i).

On Date 3, A died. Trust continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the two year period beginning on the date of the deemed owner's death and ending on Date 4. On Date 5, Trust became an ineligible shareholder, and X's S corporation election terminated.

X represents that effective Date 5, Trust was and is qualified to elect to be an electing small business trust (ESBT) within the meaning of § 1361(e). X represents that there was no intent to terminate X's S corporation election and that the failure to timely file the ESBT election for Trust was not motivated by tax avoidance or retroactive tax planning.

X and its shareholders have agreed to make any adjustments that the Secretary or Commissioner may require consistent with the treatment of X as an S corporation and the treatment of Trust as an ESBT.

Law and Analysis:

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) of the Code and § 1.1361-1(h)(1)(ii) of the Income Tax Regulations provide that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides, in part, that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion:

Based solely on the information submitted and representations made, we conclude that X's S corporation election terminated on Date 5 because the trustee of Trust failed to timely file and complete the required ESBT election under § 1361(e)(3). However, we further conclude that such termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on and after Date 5, unless X's S election is otherwise terminated under § 1362(d), provided that the respective trustee files an ESBT election with the appropriate service center within 60 days of the date of this letter effective Date 5 for

Trust, and accordingly that Trust file any amended returns that are necessary to comply with this ruling. A copy of this letter should be attached to the ESBT elections.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be treated as an S corporation or whether Trust is otherwise eligible to be treated as an ESBT.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Audrey W. Ellis

Audrey W. Ellis
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: